

# **Property Tax Appeal Affects All Levels of Government**

**By John Underwood  
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Just last month, Orange County Superior Court Judge John Watson managed to do something no public official has been able, or willing, to do since Howard Jarvis lit the fuse on a tax revolt back in 1979.

He has ruled that the County of Orange tax assessor cannot authorize property tax assessment increases above 2 percent under any circumstances, and by so doing, questioned the very method by which the county collects taxes.

By giving his judicial nod of approval to Seal Beach taxpayer Robert Pool, he not only joins him in challenging the county assessor's policy of levying property assessments in excess of the 2-percent limit imposed by Proposition 13, Watson has elevated the cause to class action status and set the stage for a high court appeal that could have an impact not only on hundreds of thousands of taxpaying property owners but on every agency and special district in the county.

Pool's case takes aim at the little understood but highly controversial property tax policy of <sup>3</sup>recapturing,<sup>2</sup> that is, assessing taxpayers in excess of 2-percent limits when property values are rising, up to a cost of living cap set by Prop. 13.

In the past few years, the practice of recapturing has accounted for alarming tax increases for thousands of Orange County property owners, in an effort by the county to make up for preceding lean years when increased tax property tax assessments could not be justified.

Judge Watson pronounced the practice <sup>3</sup>unconstitutional and violative of the Revenue and Taxation Code,<sup>2</sup> and that anyone who owned property in Orange County during the period from the mid to late 1990s-forward and was assessed more than 2 percent and had not undergone substantial property improvement was a <sup>3</sup>victim of the recapturing method<sup>2</sup> and a participant in the class action.

Such a pronouncement, if it stands, could have a far-reaching financial impact across the state.

But Judge Watson is not the final word on the matter.

This month, Assessor Webster Guillory and Treasurer/Tax Collector John Moorlach, both named in the suit, are filing an appeal with the 4th Circuit Court in Santa Ana, against the Watson decision.

The question before the court of appeals comes down to this: Does the 2 percent per year assessment limit mandated by Prop 13 apply only to the steadily rising <sup>3</sup>cost of living<sup>2</sup> increase from the base year (the year a house was purchased or substantially improved), allowing assessments to <sup>3</sup>follow the market<sup>2</sup> up or down at whatever percentage rate applies, as long as this fluctuating market driven roller coaster ride stays beneath that gradually rising 2-percent <sup>3</sup>ceiling,<sup>2</sup> as Assessor Guillory sees it, OR to hold to the strictest interpretation of Prop 13, which says <sup>3</sup>property taxes are \$ not to exceed 2 percent for any given year over the previous year's assessments<sup>2</sup> for any reason, as Pool asserts, and Judge Watson has upheld. Guillory is quick to point out, however, <sup>3</sup>No local judge in this county is going to make property tax law.<sup>2</sup>

The assessor says he's anxious to see the appeals court, or the legislature itself (the two tax-defining arms of government) put to rest once and for all the perceived <sup>3</sup>ambiguities<sup>2</sup> around Prop 13.

The legislature could step in, most likely after the appeals court has addressed the case, with anything from minor clarifications to a constitutional amendment refining or even altering the statute.

Such a move would require a hyper-majority of legislative votes to pass, and would run the risk of angering a large segment of the population who see Prop 13 as the sacred cow of tax reform few legislators would dare to tinker with on their own.

The case could even go to the state Supreme Court if the issues of <sup>3</sup>recapture<sup>2</sup> and application of the 2-percent clause cannot be clarified to everyone's satisfaction at the appeals level.

<sup>3</sup>Whoever makes the call,<sup>2</sup> Guillory said. <sup>3</sup>If Pool is upheld, there will be a significant financial impact across the board here in the county. We have no escrow fund to cover the kind of refunds to taxpayers we'd be looking at. It's going to have to come from somewhere, and we learned from our experience in '94 the state is not likely to step in.<sup>2</sup>

Next year's property taxes will generate between \$2.5 billion and \$2.8 billion, according to Guillory. The revenue is divided among 34 cities, 24 redevelopment agencies, 34 school districts, and various special and bond districts.

Every one of them is going to feel the pain, he said.

<sup>3</sup>How much will depend on to what extent each one of these entities relied on county property tax money to run their budgets in the first place,<sup>2</sup> he said. In anticipation of an appeals decision unfavorable to the county, Auditor-Controller David Sundstrom has recently compiled an updated estimate report of the potential impact of a class action refund going back four years under the current statute of limitations.

The report also projects future reductions in revenue streams to cities, districts and agencies if the recapturing method is rescinded.

<sup>3</sup>No one's going to ask the cities to cough up what they don't have,<sup>2</sup> said Sundstrom, <sup>3</sup>But if this case goes against us, there would be initial reductions of revenue to the cities of maybe 15 percent or more, and then again every year thereafter to cover ongoing future reductions to the tax base if our [recapturing] method is altered.<sup>2</sup>

Sundstrom's current revised estimate of refund allocations to approximately 200,000 potentially harmed property owners is running at about \$416 million, and another \$163 million per year thereafter.

<sup>3</sup>We're trying to stay as objective about this as possible,<sup>2</sup> he said, <sup>3</sup>But it's going to be hard to watch. You can bet every city manager is following this case very closely.<sup>2</sup>

In Robert Pool's own backyard, the city of Seal Beach stands to lose more than a half million dollars in initial refunds to local property owners who overpaid under the class action, and a \$146,000 loss to its redevelopment agency. That's just two categories of loss.

Seal Beach City Manager John Bakorski said, <sup>3</sup>In and of itself it's not a death blow. But when you couple it with a state budget crisis and a sluggish national economy, it's a three-headed monster that could take us down.<sup>2</sup> In Los Alamitos, an older community where property owners tend to predate Prop 13 and therefore do not generate the larger property tax revenues, potential exposure to a countywide refund would be relatively small. City Manager Bob Dominguez said, <sup>3</sup>The county has kept us pretty much informed on the situation for some time. We're not about to put out a for sale sign here. We'll take a small hit on this, but we're an older city. We have no community redevelopment agency. So our exposure is not as great as some of the newer cities.<sup>2</sup>

<sup>3</sup>In some cities,<sup>2</sup> Sundstrom said, <sup>3</sup>the redevelopment agencies will be dead in the water. Some of these bonds they<sup>1</sup>ve generated are going to be in trouble if this refund goes into effect.<sup>2</sup>

Cypress is one such city with a high percentage of property tax base, both commercial and residential, developed after Prop 13 was passed. So more of its revenue comes from a high property tax base, making them particularly vulnerable to revenue reductions from the county if Pool prevails. Cypress<sup>1</sup> redevelopment agency, currently very active and heavily bonded, would take a \$738,000 immediate hit, and a \$253,000 shortfall every year thereafter.

<sup>3</sup>There really will be nowhere to hide if this tax refund takes effect,<sup>2</sup> said city of Cypress Chief Financial Officer Richard Storey: <sup>3</sup>Those figures will definitely affect our redevelopment operations. If we have \$250,000 less tax increment, that could mean \$2 million less in bond money to develop a Lincoln corridor, for example. It could have an effect on whether that project goes forward or not.<sup>2</sup>

Storey goes on to say every city service will be hit. The greatest impact will be on the parks district, 75 percent of which is paid for out of property tax revenues.

Out of Cypress<sup>1</sup> \$22 million budget, the county auditor estimates the city could expect to see more than \$2 million in immediate revenue reductions. But that's not the worst of it, said Storey.

<sup>3</sup>The main problem we'd face would be the ongoing reductions of revenue if the tax base formula is limited to 2 percent,<sup>2</sup> he said.

He pointed out that being permanently limited to 2-percent property tax increases create an inherent inequity when you consider cost of living increases are customarily computed at 4 or 5 percent, and public service contracts such as police and fire are negotiated on that basis.

But the biggest impact of all would fall on the elementary school districts. About 64 percent of the county's property tax revenue stream goes to these 34 school districts. (See pie chart).

According to Sundstrom's calculations, the immediate shortfall to county public school districts would be in the area of \$261 million.

More than a third of Los Alamitos Unified School District's budget comes from local property tax dollars, which accounts for why their refund allocation shortfall would be almost \$2.8 million.

That's just for starters.

Thereafter, the yearly computed reductions to the LAUSD would be well over a million dollars into the foreseeable future.

That is a sizeable amount these days, considering that the schools are leaning precariously over the governor's own chopping block.

<sup>3</sup>These amounts are very significant for us,<sup>2</sup> said Ruben Frutos, chief business officer for the district.

The specter of property tax revenue reductions, along with the general doom and gloom coming out of Sacramento, has prompted Mr. Frutos to begin the painful process of paring down district services, as he said, <sup>3</sup>from the edges in.<sup>2</sup>

<sup>3</sup>We're looking first at cutting capital improvements and trying to keep the reductions as far away from the classrooms as possible,<sup>2</sup> Futos said, <sup>3</sup>The big question is if these [tax refund related] reductions become a reality

and we do see those kind of revenue shortfalls, will the state honor their obligations to us under Proposition 98, and make up our [reduced] local receipts?<sup>2</sup>

<sup>3</sup>Under the circumstances, we just don't know,<sup>2</sup> he said.

As the Pool case moves up to the appeals level this month, it may be worth noting that whatever the outcome, the resolution of the 2-percent rule and the <sup>3</sup>recapture<sup>2</sup> method of assessment, a decision upholding Pool will affect every county in the state from San Diego to Siskiyou, since virtually all of them have fallen into line behind the <sup>3</sup>recapturing<sup>2</sup> policy. It may also be worth noting that there does not seem to be any clear <sup>3</sup>bad guy<sup>2</sup> in all of this confusion. Tax issues are often complex formulas that serve one group at the expense of another.

As Richard Story put it, <sup>3</sup>It's a good law, but it's had some bad unintended consequences.<sup>2</sup>

David Doerr, with the California Taxpayers Association, who chaired the original legislative task force that recommended the current <sup>3</sup>recapture<sup>2</sup> method, now argues from the other side of the street.

<sup>3</sup>The practice should have been challenged a long time ago,<sup>2</sup> he said. <sup>3</sup>We fully expected it to be in '79. Then, as now, it's a law that cries out for clarification.<sup>2</sup>

What is clear is that the <sup>3</sup>recapture<sup>2</sup> method, and the view that the 2-percent ceiling only applies to a gradually increasing <sup>3</sup>cost of living cap,<sup>2</sup> has become an established policy over the years that has favored county coffers over taxpayers pockets.

Taxpayers have never been so assiduous at appealing for lower assessments when real estate values are slumping as county assessors are at raising them when the market is on the rise again.

For their part, though, both Guillory and Moorlach say all they're interested in is a clear and concise ruling so they can get back to the jobs they were elected to do, assessing and collecting the <sup>3</sup>fair and appropriate taxes under the law.<sup>2</sup>

As for Robert Pool, he says he's not interested in <sup>3</sup>breaking the bank<sup>2</sup> or <sup>3</sup>lopping off an arm of the government<sup>2</sup> on his way to making injured taxpayers whole.

<sup>3</sup>My kids go to school here too,<sup>2</sup> he said. <sup>3</sup>But what I want is to see the county honor Article XIII A of the Constitution for what it says, not for what it doesn't say, and then come to grip with a fair solution.<sup>2</sup>

It doesn't necessarily have to come to gutting public services, he said. <sup>3</sup>It could come to injured property owners in the form of tax credits stretched out over a number of years. At any rate,<sup>2</sup> Pool concludes, <sup>3</sup>the fundamental issue I hope the appeals court will consider in the coming months is not how folks will be compensated, but just what exactly the intent of the voters was when they passed Proposition 13 in the first place.<sup>2</sup>

Updates on the 2-percent assessment issue can be accessed through the county's Clerk of the Board website a <[www.oc.ca.gov/cob](http://www.oc.ca.gov/cob)>. Robert Pool's website, which contains definitions of injured taxpayers and formulas for determining tax appeals and refund info, is <[www.propertytaxrefunds.biz](http://www.propertytaxrefunds.biz)>.